

COMMITTEE ON LEGISLATIVE RESEARCH  
OVERSIGHT DIVISION

**FISCAL NOTE**

L.R. No.: 0568-01  
Bill No.: SB 146  
Subject: Corporations; Taxation and Revenue - Income  
Type: Original  
Date: January 31, 2011

---

Bill Summary: Would create individual and corporate income tax deductions for business income.

**FISCAL SUMMARY**

<b>ESTIMATED NET EFFECT ON GENERAL REVENUE FUND</b>			
FUND AFFECTED	FY 2012	FY 2013	FY 2014
General Revenue	(\$67,293,066)	(\$133,568,499)	(\$198,645,074)
<b>Total Estimated Net Effect on General Revenue Fund</b>	<b>(\$67,293,066)</b>	<b>(\$133,568,499)</b>	<b>(\$198,645,074)</b>

<b>ESTIMATED NET EFFECT ON OTHER STATE FUNDS</b>			
FUND AFFECTED	FY 2012	FY 2013	FY 2014
<b>Total Estimated Net Effect on <u>Other</u> State Funds</b>	<b>\$0</b>	<b>\$0</b>	<b>\$0</b>

Numbers within parentheses: ( ) indicate costs or losses.  
This fiscal note contains 10 pages.

ESTIMATED NET EFFECT ON FEDERAL FUNDS			
FUND AFFECTED	FY 2012	FY 2013	FY 2014
<b>Total Estimated Net Effect on <u>All</u> Federal Funds</b>	<b>\$0</b>	<b>\$0</b>	<b>\$0</b>

ESTIMATED NET EFFECT ON FULL TIME EQUIVALENT (FTE)			
FUND AFFECTED	FY 2012	FY 2013	FY 2014
General Revenue	4	4	4
<b>Total Estimated Net Effect on FTE</b>	<b>4</b>	<b>4</b>	<b>4</b>

☒ Estimated Total Net Effect on All funds expected to exceed \$100,000 savings or (cost).

☐ Estimated Net Effect on General Revenue Fund expected to exceed \$100,000 (cost).

ESTIMATED NET EFFECT ON LOCAL FUNDS			
FUND AFFECTED	FY 2012	FY 2013	FY 2014
<b>Local Government</b>	<b>\$0</b>	<b>\$0</b>	<b>\$0</b>

---

## **FISCAL ANALYSIS**

Officials from the **Office of the Secretary of State** assume this proposal would have no fiscal impact on their organization.

Officials from the **Office of Administration, Division of Budget and Planning** (BAP) assume this proposal would not result in additional costs or savings to their organization.

BAP officials stated that this proposal would provide deductions from taxable income for "business income".

The proposal would phase in a deduction of business income from corporate tax, increasing from 10% in 2011 to 50% in 2012. BAP assumes all corporate income is business income and notes that net corporate income tax collections in FY 2010 were \$195 million. Therefore, this proposal would reduce general and total state revenues by \$19.5 million in FY 2012, \$39 million in FY 2013, \$58.5 million in FY 2014, \$78 million in FY 2015, and \$97.5 million in FY 2016.

BAP also notes that FY 2010 corporate income tax collections were historically low, so actual revenue losses may exceed those estimates. For comparison, FY 2008 net corporate income tax collections were about \$370 million. Using these figures, this proposal would reduce general and total state revenues by \$37 million in FY 2012, increasing to \$185 million by FY 2016.

The proposal would also phase in a deduction of business income from individual income tax, increasing from 10% in 2011 to 50% in 2016. According to the IRS Statistics of Income (SOI) estimates, \$3.72 billion of business income was reported in tax year 2008, or 2.7% of \$139.19 billion in total income. Net individual income tax collections in FY 2010 were \$4,434 million. Using the ratio calculated above, an estimated \$120 million in income tax was derived from individuals' business income. Therefore, this proposal would reduce general and total state revenues by \$12 million in FY 2012, \$24 million in FY 2013, \$36 million in FY 2014, \$48 million in FY 2015, and \$60 million in FY 2016.

BAP also notes that FY 2010 individual income tax collections were historically low, so actual revenue losses may exceed those estimates. For example, FY 2008 net income tax collections were about \$5,210 million. Using the ratio calculated above would imply an estimated \$141 million in income tax from individuals' business income, and this proposal would reduce general and total state revenues by \$14.1 million in FY 2012, increasing to \$70.5 million in FY 2016.

ASSUMPTION (continued)

BAP also noted that while the SOI data specifically identified "business income" there may be other forms of business income that aren't clearly identified in the SOI data. In that case, losses to general and total state revenues would increase.

Officials from the **Department of Revenue** (DOR) assume this proposal would reduce corporation and individual income tax.

This proposal would provide a corporate tax exemption as follows:

- \* Between January 1, 2011 and December 31, 2011, ten percent (10%) of the corporation's Missouri taxable income,
- \* Between January 1, 2012 and December 31, 2012, twenty percent (20%) of the corporation's Missouri taxable income,
- \* Between January 1, 2013 and December 31, 2013, thirty percent (30%) of the corporation's Missouri taxable income,
- \* Between January 1, 2014 and December 31, 2014, forty percent (40%) of the corporation's Missouri taxable income, and
- \* Beginning January 1, 2015, fifty percent (50%) of the corporation's Missouri taxable income.

The proposal would also create a subtraction from the federal adjusted gross income of an individual taxpayer, provided that income is included in federal adjusted gross income:

- \* Beginning January 1, 2011, but before December 31, 2011, ten percent (10%) of the amount of business income,
- \* Beginning January 1, 2012, but before December 31, 2012, twenty percent (20%) of the amount of business income,
- \* Beginning January 1, 2013, but before December 31, 2013, thirty percent (30%) of the amount of business income,
- \* Beginning January 1, 2014, but before December 31, 2014, forty percent (40%) of the amount of business income, and
- \* Beginning January 1, 2015, fifty percent (50%) of the amount of business income.

DOR officials stated that they would need to make changes to tax forms and instructions, and DOR and ITSD-DOR would need to make programming changes to various processing systems.

ASSUMPTION (continued)

Administrative impact

DOR officials assume that:

- \* Personal Tax would require two additional Temporary Tax Employees for key entry, one additional FTE Revenue Processing Technician I (Range 10, Step L) per 19,000 additional errors, and one additional FTE Revenue Processing Technician I (Range 10, Step L) per 2,400 pieces of correspondence;
- \* Corporate Tax would require one additional FTE Revenue Processing Technician I (Range 10, Step L) per 2,600 additional pieces of correspondence, including one FTE for CARES phone and agent license, and one additional FTE Revenue Processing Technician I (Range 10, Step L) per 7,800 additional errors, including one FTE for CARES phone and agent license;
- \* Collections and Tax Assistance (CATA) - DOR assumes there would be an increase in adjustments to individual income tax returns due to the calculation to reduce taxable income. CATA would see an increase in contacts, and would require one additional FTE one additional FTE Tax Collection Technician I (Range 10, Step L) for every additional 15,000 contacts annually to the non-delinquent tax line, including one FTE for CARES phone and agent license, one additional FTE Tax Collection Technician I (Range 10, Step L) for every additional 15,000 contacts annually to the delinquent tax line, including one FTE for CARES phone and agent license, and one additional FTE Revenue Processing Technician I (Range 10, Step L) for every additional 4,800 contacts annually to the field offices.

In summary, DOR provided an estimate of the administrative cost to implement this proposal including two temporary tax season employees and seven additional full time employees. The total, including the additional employees and the related fringe benefits, equipment, and expense, totaled \$299,867 for FY 2012, \$298,927 for FY 2013, and \$302,063 for FY 2014.

**Oversight** assumes the DOR estimate of expense and equipment cost for additional FTE could be overstated. If DOR is able to use existing equipment such as desks, file cabinets, chairs, etc., the estimate for equipment for fiscal year 2012 could be reduced by roughly \$5,000 per employee.

ASSUMPTION (continued)

**Oversight** notes that a substantial majority of individual tax filers will use tax preparation software or have their return prepared by a paid preparer, and virtually all corporate filers will have returns prepared by a paid preparer or corporate officer. Accordingly, the number of calculation errors would be significantly reduced over previous years and the DOR estimate of additional FTE may be overstated. Oversight assumes this proposal could be implemented with four additional FTE. Since this proposal would become effective for tax years beginning January 1, 2011 it would first impact tax returns filed in January 2012 (FY 2012). Oversight will include six months cost for DOR in FY 2012.

**Oversight** has, for fiscal note purposes only, changed the starting salary for the additional positions to correspond to the second step above minimum for comparable positions in the state's merit system pay grid. This decision reflects a study of actual starting salaries for new state employees for a six month period and the policy of the Oversight Subcommittee of the Joint Committee on Legislative Research. Oversight has adjusted the DOR estimate of equipment and expense cost in accordance with OA budget guidelines, and Oversight assumes a limited number of additional employees could be accommodated in existing office space.

DOR officials also provided an estimate of the IT cost to implement the proposal; the cost estimate was \$53,424 based on 2016 hours of programming to update DOR processing systems.

**Oversight** assumes ITSD-DOR is provided with core funding to handle a certain amount of activity each year. Oversight also assumes that ITSD-DOR could absorb the costs related to this proposal. If unanticipated costs are incurred or if multiple proposals are implemented which create a substantial workload, ITSD-DOR could request funding through the budget process.

ASSUMPTION (continued)

Revenue impact

DOR officials stated that in 2008 there were 250,927 federal individual income tax returns filed by individuals with a Missouri address who reported business income totaling \$3,776,064,897. Those same taxpayers had an effective tax rate of 3.62% on all of their sources of income. The table below reflects the total reduction in tax for each tax year.

Year	Revenue Reduction	Tax Reduction	Percentage Reduction
2011	\$377,606,490	\$13,669,355	10%
2012	\$755,212,979	\$27,338,710	20%
2013	\$1,132,819,469	\$41,008,065	30%
2014	\$1,510,425,959	\$54,677,420	40%
2015	\$1,888,032,449	\$68,346,775	50%

In addition, DOR officials stated that in FY 2010, corporations paid approximately \$290 million dollars in corporate income taxes (total collections minus refunds). Based on the assumption that similar amounts would be paid in each of the affected tax years, the following table represents the annual reduction in corporate income tax:

Tax year	Revenue reduction
2011	\$29 million
2012	\$58 million
2013	\$87 million
2014	\$116 million
2015	\$145 million

ASSUMPTION (continued)

Officials from the **University of Missouri, Economic and Policy Analysis Research Center** (EPARC) assume this proposal would, if enacted phase-in over five years a 50% business income exemption for corporate taxpayers. In addition, it would phase-in over five years a 50% business income subtraction from Federal Adjusted Gross Income when calculating an individual's Missouri Adjusted Gross Income. For 2011, ten percent of business income would be exempted/subtracted; for 2012, twenty percent of business income would be exempted/subtracted; for 2013, thirty percent of business income would be exempted/subtracted; for 2014, forty percent of business income would be exempted/subtracted respectively; and finally, for 2015, fifty percent of business income would be exempted/subtracted respectively.

The following estimates were generated using the latest available corporate tax data from 2008 and the latest available individual income tax data from 2009. (Numbers in \$ millions)

Year	Exemption or Subtraction Percentage	Corporate Income Tax Liability	Individual Income Tax Liability	Total Income Tax Liability	Net Change in General Revenue
Baseline	0	\$369.862	\$4,395.185	\$4,765.047	\$0.000
2011	10%	\$332.876	\$4,364.980	\$4,697.856	\$67.191
2012	20%	\$295.890	\$4,335.757	\$4,631.647	\$133.400
2013	30%	\$258.903	\$4,307.672	\$4,566.575	\$198.472
2014	40%	\$221.917	\$4,281.009	\$4,502.926	\$262.121
2015	50%	\$184.931	\$4,255.984	\$4,440.915	\$324.132

**Oversight** will use the EPARC estimates of revenue impact, and notes that this proposal would become effective for tax periods beginning January 1, 2011 and would first impact tax returns filed in FY 2012.

<u>FISCAL IMPACT - State Government</u>	FY 2012 (10 Mo.)	FY 2013	FY 2014
<b>GENERAL REVENUE FUND</b>			
<u>Cost - Department of Revenue</u>			
Salaries (4.0 FTE)	(\$45,360)	(\$93,442)	(\$96,245)
Temporary help	(\$7,800)	(\$15,756)	(\$15,914)
Fringe benefits	(\$27,824)	(\$57,154)	(\$58,704)
Expense and equipment	<u>(\$21,082)</u>	<u>(\$2,147)</u>	<u>(\$2,211)</u>
Total	<u>(\$102,066)</u>	<u>(\$168,499)</u>	<u>(\$173,074)</u>
<u>Revenue reduction - business income exemption</u>	<u>(\$67,191,000)</u>	<u>(\$133,400,000)</u>	<u>(\$198,472,000)</u>
<b>ESTIMATED NET EFFECT ON GENERAL REVENUE FUND</b>	<b><u>(\$67,293,066)</u></b>	<b><u>(\$133,568,499)</u></b>	<b><u>(\$198,645,074)</u></b>
Estimated Net FTE Effect on General Revenue Fund	4	4	4
 <u>FISCAL IMPACT - Local Government</u>	 FY 2012 (10 Mo.)	 FY 2013	 FY 2014
	<u>\$0</u>	<u>\$0</u>	<u>\$0</u>

FISCAL IMPACT - Small Business

This proposal would have a direct fiscal impact to small businesses.

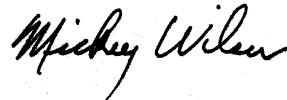
FISCAL DESCRIPTION

The proposed legislation appears to have no fiscal impact.

This legislation is not federally mandated, would not duplicate any other program and would not require additional capital improvements or rental space.

SOURCES OF INFORMATION

Office of the Secretary of State  
Office of Administration  
    Division of Budget and Planning  
Department of Revenue  
University of Missouri  
    Economic and Policy Analysis Research Center

A handwritten signature in black ink that reads "Mickey Wilson". The signature is written in a cursive, flowing style.

Mickey Wilson, CPA  
Director  
January 31, 2011